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SUBJECT: MADRID WEEKLY ECON/AG/COMMERCIAL UPDATE REPORT -  
JULY 9

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EFIN: High corporate debt levels prompt tougher credit conditions  
EFIN: Holding companies are rigorously inspected by tax agency  
EINV/ENRG: CNE approves Enel and Acciona's bid for Endesa  
SENV/BEXP: Chinese toothpaste seized due to contamination  
EAGR/BEXP: Bad year for U.S. wheat exports to Spain  
EFIN: Opposition conservative party offers tax cuts  
ECIN: Egyptian Minister promotes economic cooperation  
EAIR/ELAB: SpanAir strike over  
ECON: 2008 Budget: More R&D and infrastructure investment  
ENRG: Expert Spanish wind power companies armed and ready to tackle U.S. market

#### HIGH SPANISH CORPORATE DEBT LEVELS PROMPT TOUGHER CREDIT CONDITIONS

11. (U) Standard & Poor's says Spanish corporate debt is at 106% of GDP, compared with a 70% Eurozone average. The result is that banks are having a harder time syndicating loans. Colonial's (a major Spanish real estate group) chief financial officer says there has been a "radical change in the perception of Spanish country risk." A year ago, banks were reportedly willing to lend up to 120% of a real estate group's net asset value; now they are only willing to lend up to 30% in most cases. (Comment: There is a sense that higher interest rates will at least slow down Spain's construction-led boom. But many analysts remain bullish, noting that even with recent interest rate hikes, Spanish businesses and consumers can handle the more expensive money because it still remains much cheaper than it was prior to Spain's entry into the euro.) (Financial Times, July 10).

#### SPANISH TAX AGENCY INSPECTS SPANISH ENERGY HOLDING COMPANIES' DEDUCTIONS MORE RIGOROUSLY

12. (U) The Spanish Tax Agency believes that some holding companies have taken undue advantage of a 1996 law that provided tax benefits for holding companies. The idea was to attract foreign investment, and the law did, in fact, do that. Apparently some Tax Agency inspectors believe that the financial cost deductions taken by holding companies may be excessive. (Comment: The reason this is interesting to us is that American holding companies have complained that the Spanish tax authorities have effectively changed the rules retroactively for holding companies. We are encouraging the GOS to study the issue with a view to maintaining a good investment climate. The Spanish Tax Authority is, however, not necessarily amenable to political direction so this will be a challenging issue to manage.) (Expansion, July 9)

#### CNE APPROVES ENEL AND ACCIONA'S BID FOR ENDESA

13. (U) The Spanish National Energy Commission (CNE) approved this past week Enel and Acciona's bid to buy major Spanish energy utility Endesa. The approval came with twelve conditions attached, including stipulations that Endesa preserve its brand identity and headquarters in Spain and that the CNE maintain the ability to veto decisions which could endanger the Spanish national interest. Enel is required to maintain Endesa as a separate company and not absorb it. Furthermore, CNE maintained that a separate management team must be set up within Endesa to manage nuclear power operations, and thereby keep Enel, in which the Italian government holds a significant stake, from gaining too much control over Spain's nuclear plants.

#### CONTAMINATED TOOTHPASTE HITS SPAIN

14. (U) Spanish authorities seized approximately 100,000 tubes of contaminated toothpaste on July 6 originating from China. After further investigation, local authorities determined that the toothpaste was contaminated with the same chemical, diethylene glycon, as the contaminated Colgate tubes discovered in the United States. The affected products seized in Spain were of a non-name brand toothpaste commonly distributed in local hospitals and on airplanes.

#### SPANISH WHEAT MARKET SURPLUS TO LIMIT US EXPORTS

15. (U) The prospects for U.S. high-quality Hard Red Spring and durum wheat sales to Spain appear to be greatly reduced this year, when compared to previous marketing years. Now, approaching the end of the grain harvest, it appears that Spanish grain yields and production have reached record levels, as a result of the timely and plentiful springtime rains and dry harvest-time weather. Among the various grains produced in Spain, the improvements in wheat and barley

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yields and production, over those of previous years, have been especially significant. In addition, grain quality is reported to be extremely good, which will likely result in reduced demand for high-quality wheat imports from North America because Spanish millers will require less high-protein wheat to mix with the normally poorer-quality Spanish soft wheat. Spanish pasta makers will also have plenty of local durum wheat, so as not to require high quality imports.

#### OPPOSITION CONSERVATIVE PP PARTY OFFERS TAX CUTS

16. (U) PP leader Mariano Rajoy used a July 10 PriceWaterhouse lunch attended by Spain's business elite to offer to eliminate the wealth tax; reduce personal income taxes between 12% and something below 40%; reduce corporate income taxes to 25% for most companies and 20% for small businesses; eliminate the tax levied on corporate financial restructuring; reduce or eliminate taxes on certain legal transactions; and reform the estate tax. (Comment: This is clearly an electoral offer - elections must be held by March 2008 at the latest. The tax cut ideas were not followed by specific plans for savings, something of a disappointment for fiscal hawks - the PP normally argues for more fiscal restraint. Interestingly, the proposal to eliminate taxes on legal transactions would benefit the real estate sector the most, an area the PP clearly sees might need shoring up given widespread fears of a real estate bubble. Rajoy's ideas followed President Zapatero's pledge to pay families 2500 euros for each new baby. Clearly, both political parties are trying to reach voters through economic proposals, although terrorism and constitutional issues will still likely dominate the elections.) On July 11, Finance Minister Solbes rejected Rajoy's tax cuts because he said they would lead to a budget deficit on the order of 0.4% of GDP. (Expansion, July 10; July 11)

EGYPTIAN MINISTER OF FOREIGN TRADE AND INDUSTRY PROMOTES  
ECONOMIC COOPERATION IN SPAIN

¶7. (U) Egyptian Minister of Foreign Trade and Industry, Rachid Mohamed Rachid, visited Spain in hopes of promoting investment and economic cooperation between the two nations. Accompanied by a delegation of representatives from 50 leading Egyptian businesses, the group met with notable Spanish businesses such as Union Fenosa, Iberdrola, Cepsa, Corte Ingles, and Banco Santander. Rachid was quoted as saying that the meetings were very positive, particularly those meetings with representatives from the energy and tourism sectors. (Note: Egypt is currently a minor supplier of petroleum to Spain). During his visit, the Egyptian Minister also met with Minister of Industry, Commerce and Tourism Joan Clos, who promised a reciprocal visit to Egypt in October.

SPANAIR AIRLINE STRIKE OVER

¶8. (U) SpanAir, one of Spain's most well known airlines, reached an agreement July 6 with the Independent Union of Cabin Airline Crew (SITC-PLA) to grant its employees concessions on work hours and scheduling issues. This agreement brought to a close employee strikes which affected over 100 SpanAir flights since the strike's commencement June ¶25. SpanAir, a member of the Scandinavian travel group Star Alliance, operates a fleet of over 60 aircraft and employs more than 3,600 people.

2008 BUDGET: MORE R&D AND INFRASTRUCTURE INVESTMENT

¶9. (U) The Secretary General of Budgeting at the Ministry of Economy and Treasury, Luis Espadas, announced that research and development, infrastructure investment, and social spending would be the leading priorities in the 2008 budget, the last budget for this administration. He noted that the budget ceiling had already been approved by the Council of Ministers and signed off on by Congress at 152.6 billion euros, a 6.7 percent increase over 2007. Congressional discussion on the details of the 2008 budget is expected to occur late September.

SPANISH COMPANIES EXPERT IN WIND POWER ARMED AND READY TO  
TACKLE GROWING U.S. MARKET

¶10. (U) The United State's recent appetite for renewable wind energy has created a shortage in the wind turbines needed to generate the power. Due to the nature of the production of wind turbines, like airplanes requiring many high-tech

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pecially made components from many different producers, the recent jump in demand has left turbine manufacturers with long order backlogs. Being relatively new to the game, American renewable energy companies have found themselves at the back of the line and without the equipment to increase their wind power generation. This has created a unique opportunity for European players such as Spain's Iberdrola, a world leader in renewable energy which holds many of the new turbine production contracts over the next few years. The result is that Iberdrola is now being welcomed as it seeks to acquire U.S. firms in search of turbines. The company has bought small companies in Pennsylvania, Iowa and Virginia, as well as Maine utility Energy East for 4.58 billion in June ¶2007. Similarly, Spanish turbine manufactures Gamesa and Acciona have been opening plants in the United States in order to meet new demand. Part of the reason the United States has lagged behind in wind power has been inconsistent government support for the technology. That support appears to be solidifying and old hand European companies are looking to reap the benefits.  
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